

the aftermarket analyst

A PUBLICATION FOCUSED ON MERGERS, ACQUISITIONS AND CORPORATE FINANCE IN THE AUTOMOTIVE AFTERMARKET INDUSTRY

***Another* Distribution Shift**

For the last few years, this publication has discussed the paradigm shift that has occurred in the aftermarket accessories segment of the market. In 2007, we predicted the shift in the distribution of accessories away from the traditional 3-step model towards a two-step or one-step model. The rise of the internet, increased competition at the manufacturer level, and heavy-handed tactics by some warehouse distributors are the major factors for the distribution change. We are now on the verge of another dramatic shift in North American distribution — one which will impact hard parts manufacturers as well — as the automotive aftermarket adjusts to changes in the broader automotive industry. Such macro factors as increasing foreign competition, vehicle complexity, parts proliferation, and extended warranties are drivers of this new shift in distribution.

Increasing Foreign Competition

Ten years ago, Detroit's Big 3 dominated the American automotive market. GM (28%), Ford (23%) and Chrysler (16%) produced 67% of all vehicles sold in North America. Asian manufacturers had limited success in the U.S. market then, with all Asian manufacturers totaling 25% of sales. Today, the U.S. is the most competitive automotive market in the world. American manufacturers now produce only 44% of all vehicles sold in the U.S., led by GM (19%), Ford (17%) and Chrysler (8%). Foreign competitors have entered the market and are commanding market share. In 1999, only 7 manufacturers had more than 2% of the American automotive market. Today, that number is 13. With more manufacturers comes the need for more parts, and

increasing numbers of vehicle models further exacerbates that need. Today, parts providers would be required to almost double the number of SKUs on hand versus 1999 levels due to the increasing number of foreign manufacturers.

Vehicle Complexity

Gone are the days when a local independent service station or shade tree mechanic could service an entire automobile. The electronic systems in modern cars and trucks are packed with up to 100 million lines of computer code, more than in some jet fighters. Even basic vehicles have at least 30 of these microprocessor-controlled devices, known as electronic control units, and some luxury cars have as many as 100. Mechanics must undergo frequent training to keep up with the automobiles of today. "It would be easy to say the modern car is a computer on wheels, but it's more like 30 or more computers on wheels," said Bruce Emaus, the chairman of SAE International's embedded software standards committee. The Do-it-Yourself (DIY) market is adversely affected, as what used to be routine repairs now fall outside the abilities of most DIYers. More importantly, these systems are driving more consumers back to the new vehicle dealer for service.

Parts Proliferation

The proliferation of replacement hard parts that a traditional auto parts retailer would have to carry to accommodate every new vehicle made in the U.S. has

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RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor(s)	Target	Target Description
1/14/2011	EnPro Industries	Rome Tool and Die	a leading supplier of steel brake shoes to the North American heavy-duty truck market
1/14/2011	Uni-Select	Finishmaster	Indianapolis PBE distributor
1/4/2011	Inteva Products LLC	Arvin Meritor	Arvin Meritor's body systems business
12/27/2010	Friedman Fleisher & Lowe	Transtar Industries	a distributor of complete transmission units, automatic and standard transmission rebuilder kits, hard and soft parts, electrical components, torque converters, transfer cases, and high-performance engine parts, and auto body refinishing solutions to the automotive repair industry
12/22/2010	Littelfuse	Cole Hersee Co.	a leader in the off-road, truck and bus (OTB) market
12/22/2010	Trelleborg	Lutz Sales, Inc.	a distributor of a broad range of precisions seals and customer-specific rubber components for the North American market
12/21/2010	Insight Equity Holdings (Atwood Mobile Products)	Fan-Tastic Vent	a market leader in 12-volt powered vents, selling primarily to the recreational vehicle ("RV") market
12/20/2010	FleetPride	Friction Materials	a manufacturer and supplier of automotive brake friction materials and aftermarket brake products
12/14/2010	Century Park Capital Partners (Eckler Industries)	Dearborn Classics	the world's leading provider of restoration parts and accessories for mid-sized and full-sized Fords
12/14/2010	Castle Harlan	IDQ Holdings, Inc.	an automotive aftermarket company focused on do-it-yourself automotive air conditioner repair
12/13/2010	American Tire Distributors	Lisac's of Washington, Inc. and Tire Wholesalers, Inc.	Services more than 1,400 customers in Montana, Washington, Oregon and northern Idaho. Tire Wholesalers operates one distribution center in Kent, Wash., to service more than 750 customers in western Washington.
12/11/2010	Pendergast Partners	Magnuson Products, Inc.	a premier designer and manufacturer of OEM and aftermarket automotive superchargers
12/10/2010	Bosch	RTI Technologies	manufactures and distributes automotive maintenance equipment, most notably air conditioning service machines
12/1/2010	Littlejohn & Co.	Henniges Automotive Holdings Inc.	manufactures a complete line of automotive sealing systems for doors, windows, trunks, lift gates, sunroofs and hoods
11/29/2010	THI, Inc. (Kinderhook)	Advantage Truck Accessories	produces a range of tonneau covers such as the TorzaTop, Sure-Fit and Hard Hat
11/23/2010	International Automotive Components Group (IAC)	AMPRO Molding	manufactures a variety of vehicle interior components
11/22/2010	HIG Capital/Stant Corp.	Shelby Enterprises	supplies filler pipe, vapor line and other products to the automotive industry

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become insurmountable. It was possible when it was only the Big 3 making a few models. The increased number of manufacturers and increased number models by each manufacture has geometrically increased the SKUs necessary to keep in stock. Accordingly, many retailers are shying away from stocking even a few of them. A notable example is Canadian Tire, which now is diminishing its auto parts line and getting into kitchen and bath accessories. As another example, many of the auto parts stores in Europe are focusing on vehicle cleaning products and air filters, with very few hard parts.

Extended Warranties

The age old "3 years or 36,000 mile" warranty is also going the way of buggy whips. Many manufacturers have increased their warranties substantially, with some as high as 100,000 miles. This increased offering is not necessarily expensive to them because the quality of the vehicle is better and they can expect fewer warranty claims. Worldwide competition and well-known foreign quality has forced the old Big 3 to improve their quality. Additionally, many OEMs are offering free service to further drive consumers into new vehicle dealers. These fully inclusive warranties have become very effective sales tools.

So . . .

We believe all of these factors are going to drive an increasing amount of maintenance and repair service to new vehicle dealers. As you go further back up the food chain, that means that manufactures of hard parts will have to utilize different distribution channels in order to get their parts to the end user. While not

necessarily bad news for any manufacturer, it means that all must adapt to this new way of selling their products. Just ask accessory manufactures whose sales have dropped by 50% since 2007 because they were too slow to embrace change. Many of these manufacturers have lost a disproportionate amount of value in their companies, a factor we encounter in way too many deals these days.

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Selected Public Company Capitalization and Operating Figures
 (\$ in millions, except per share data)

Company	Enterprise Value				Last Twelve Months (LTM)				
	Price as of 1/15/11	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
Manufacturers									
Federal-Mogul Corporation	\$23.21	\$2,295.6	\$2,856.0	\$1,054.0	\$4,320.6	9/30/10	\$6,039.0	\$593.0	\$149.7
Tenneco Automotive, Inc.	45.07	2,703.7	1,297.0	184.0	3,964.6	9/30/10	6,949.0	506.0	(187.2)
Dorman Products, Inc.	36.67	653.9	0.3	18.9	657.2	9/25/10	429.9	76.3	41.7
Standard Motor Products, Inc.	13.60	310.1	74.3	13.4	371.1	9/30/10	798.1	58.4	19.9
Wholesalers & Distributors									
Genuine Parts Company	\$51.15	\$8,057.9	\$500.0	\$531.7	\$8,103.3	9/30/10	\$10,871.1	\$855.3	\$456.0
LKQ Corporation	23.33	3,369.4	597.5	168.7	3,933.6	9/30/10	2,351.7	326.2	163.1
The Coast Distribution System, Inc.	4.12	19.2	9.5	7.0	21.6	9/30/10	108.3	2.6	0.8
Retailers									
Autozone, Inc.	\$252.62	\$11,273.4	\$2,882.3	\$98.3	\$14,464.6	8/28/10	\$7,362.6	\$1,511.5	\$738.3
Advance Auto Parts, Inc.	63.18	5,310.5	302.2	194.5	5,565.8	10/9/10	5,798.6	719.7	332.4
O'Reilly Automotive, Inc.	57.31	8,002.6	431.3	43.2	8,687.9	9/30/10	5,260.9	850.4	398.3
The Pep Boys - Manny, Moe & Jack	13.19	692.1	306.7	92.4	915.0	8/1/10	1,940.4	134.8	25.9
US Auto Parts Network, Inc.	9.19	279.5	25.0	24.5	280.6	9/30/10	227.6	11.6	(10.4)

Selected Public Company Multiples and Operating Statistics

Company	Enterprise Value /					P / E Ratio	Margins		
	Revenue	EBIT	EBITDA	Free Cash Flow (2)	Net Income		Gross Margins	EBITDA Margins	Net Margins
Manufacturers									
Federal-Mogul Corporation	0.7x	16.4x	7.3x	10.9x	28.9x	15.3	16.4%	9.8%	2.5%
Tenneco Automotive, Inc.	0.6x	14.0x	7.8x	15.6x	NM	NM	15.7%	7.3%	NM
Dorman Products, Inc.	1.5x	9.6x	8.6x	9.8x	15.8x	15.7	37.8%	17.8%	9.7%
Standard Motor Products, Inc.	0.5x	8.3x	6.4x	7.8x	18.6x	15.6	25.4%	7.3%	2.5%
Mean	0.8x	12.1x	7.5x	11.0x	21.1x	15.5x	23.8%	10.5%	4.9%
Median	0.6x	11.8x	7.6x	10.3x	18.6x	15.6x	20.9%	8.6%	2.5%
Wholesalers & Distributors									
Genuine Parts Company	0.7x	10.6x	9.5x	10.4x	17.8x	17.7	29.5%	7.9%	4.2%
LKQ Corporation	1.7x	13.8x	12.1x	15.0x	24.1x	20.7	45.0%	13.9%	6.9%
The Coast Distribution System, Inc.	0.2x	11.9x	8.3x	9.2x	27.5x	24.4	18.4%	2.4%	0.7%
Mean	0.9x	12.1x	9.9x	11.5x	23.1x	20.9x	31.0%	8.0%	4.0%
Median	0.7x	11.9x	9.5x	10.4x	24.1x	20.7x	29.5%	7.9%	4.2%
Retailers									
Autozone, Inc.	2.0x	11.0x	9.6x	12.1x	19.6x	15.3	50.4%	20.5%	10.0%
Advance Auto Parts, Inc.	1.0x	10.0x	7.7x	10.9x	16.7x	16.0	49.7%	12.4%	5.7%
O'Reilly Automotive, Inc.	1.7x	12.5x	10.2x	18.2x	21.8x	20.1	48.5%	16.2%	7.6%
The Pep Boys - Manny, Moe & Jack	0.5x	14.5x	6.8x	11.2x	35.4x	26.7	25.8%	6.9%	1.3%
US Auto Parts Network, Inc.	1.2x	116.5x	24.2x	NM	NM	NM	34.6%	5.1%	NM
Mean	1.3x	12.0x	11.7x	13.1x	23.4x	19.5x	41.8%	12.2%	6.2%
Median	1.3x	11.7x	9.6x	11.6x	20.7x	18.0x	49.1%	14.3%	6.7%

(1) Enterprise Value equals market cap, plus debt, minus cash

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful